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TAGS: ECON EFIN EINV ETRD HK CH
SUBJECT: HK Market Update, Nov. 28 -- More RMB Business in HK?

¶1. Summary: In recent meetings, HKMA Chief Joseph Yam asked Beijing officials to allow expanded RMB business in Hong Kong, but local analysts are skeptical that Beijing will respond positively. Standard Chartered Bank is proposing to raise HKD 20 billion in the equity markets in a plan that could spell the end of their right to issue Hong Kong currency. The minibond saga continues, as reports suggest U.S. bankruptcy law may prevent Lehman Bros.'s CDS's from being liquidated, throwing a wrench into plans for Hong Kong banks to buy back CDS-backed minibonds. Hong Kong's Securities and Futures Commissions defended short-selling as the Hang Seng Index gained almost 10 percent on the week. End Summary.

Yam Advocates for RMB Business in Hong Kong

¶2. HKMA Chief Executive Joseph Yam, returning to Hong Kong from meetings in Beijing with the Association of Hong Kong Banks, told the press Tuesday that Hong Kong bankers were lobbying the Chinese government to permit expanded RMB business in Hong Kong, including the use of RMB as the settlement currency for Mainland-Hong Kong trade and allowing both financial and non-financial institutions to issue RMB bonds in Hong Kong. Bank of China (Hong Kong) Chief Executive and Chairman of the Association of Hong Kong Banks He Guangbei cautiously confirmed Yam's announcement, adding that "discussions are going on and no details can be given for the time being."

¶3. The pro-Beijing Hong Kong Commercial Daily on Wednesday, November 26 quoted independent local economist Andy Xie saying he did not expect any progress on Yam's proposal as it would require liberalization of the Mainland foreign exchange market. Xie added that China is not likely to make a change in trade settlement policy in the current environment. On November 28, local press reported PBOC officials, including Vice Governor Ma Delun and Research Department Head Zhang Jianhua, saying they were concerned about the impact on the Hong Kong dollar if large volumes of RMB flood into Hong Kong.

StanChart Thinking Creatively About RMB Lending

¶4. Standard Chartered Bank economist Nicholas Kwan told the press on Monday that it might be more useful to persuade PBOC officials to allow Hong Kong banks to take the 70 billion RMB in deposits that they currently hold and make RMB loans to Hong Kong factories in Mainland. At present, the Hong Kong banks are permitted to accept RMB deposits but not allowed to issue RMB loans. Kwan estimated that Hong Kong-based borrowers market could be as much as 300 billion RMB, if Chinese officials would grant the green light.

Raising Capital, Losing Currency?

¶5. Standard Chartered, one of three currency issuing banks in Hong Kong, announced this week that it would seek to raise HKD 20 billion to strengthen its capital base through a rights issue. HKMA's Yam reiterated longstanding government policy that prohibits foreign governments from controlling over 20 percent of a note issuing bank. Analysts warned that the announced terms of the offer could force

Singapore's Temasek Holdings to raise its stake in Standard Chartered Hong Kong from 19 to 22 percent if the rights issue is not taken up by the market. Standard Chartered Bank Hong Kong Chief Executive Benjamin Hung assured the press that Standard Chartered definitely wants to maintain its status as a note issuer and that he saw no reason to believe the rights issue would not be welcomed by the market.

Minibond Buyback Plan in Peril

¶6. On Thursday, November 27, local press reported that HSBC might not be allowed to liquidate credit default swaps (CDSs) backing minibonds issued by Lehman Bros.' in light of claims filed against Lehman by creditors in the U.S. Lehman Bros.' is reportedly seeking authority from the court to assume and sell off derivative contracts it entered into before its bankruptcy. If granted, the motion would make it illegal for Hong Kong banks to terminate credit default swaps that underlie minibonds sold in Hong Kong.

¶7. Hong Kong banks' plan to compensate minibond investors requires them to terminate swap arrangements involving the minibonds and then sell off the minibonds' underlying assets. The US Bankruptcy Court in New York will reportedly hear Lehman's motion on Wednesday, December 3. A spokesman from the Association of Hong Kong Banks told the Hong Kong Economic Journal that banks are currently seeking legal opinions on the feasibility of the buyback plan. Financial Secretary John Tsang said Thursday that the buyback plan remains the best option for investors and banks.

Hong Kong SFC Defends Short-Selling

¶8. On Monday, November 24, the Hong Kong Securities and Futures

Commission participated in a telephone conference with other market regulators, including the U.S., to discuss short-selling activities. The Hong Kong Securities and Futures Commission argued strongly in support of short-selling as a tool for hedging purposes. Statistics released by the Commission indicated that the value of short-selling transactions remained stable in recent months, accounting for less than 10 percent of the average daily turnover of the Hong Kong stock market.

Hang Seng Up on PBOC Rate Cut, Citi Bailout

¶9. The Hang Seng Index gained 9.7 percent or 1229.04 points this week, closing at 13888.24 as investors responded positively to Chinese interest rate cuts and news of the U.S. Government's plan to bail out Citibank. Turnover on Friday was HKD 42.3 billion, about 60 percent less than the daily volume of HKD 104.1 billion recorded on Nov. 28, 2007. China's aggressive 108 basis point interest rate cut, announced on Wednesday, only pushed up the Hang Seng Index by 1.4 percent or 182.61 points on Thursday.

¶10. HIBOR closed Friday at 0.5 percent for overnight, 0.7 percent for 1-W, 1.10 percent for 1-M and 1.95 percent for 3-M. Though the cost for borrowing money from the interbank market has been sliding down as the HKMA intervenes, business leaders in Hong Kong have continued to push the government to increase its guarantee for SME borrowers from 70 to 100 percent to encourage additional bank lending to smaller enterprises. Some analysts are predicting that 25 percent of Hong Kong enterprises running factories in the Pearl River Delta might have to close their businesses after Chinese New Year. HKMA Chief Executive Joseph Yam is reportedly planning to accompany the Federation of Hong Kong Industries to visit Guangdong to explore ways to assist Hong Kong factories short of capital.